

Will Your Nonprofit Be Here Next Year?

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Map of Nonprofits

- Nonprofit Corporations
 - Public Benefit Corporation
 - formed for public or charitable purposes
 - may not distribute corporate assets to members
 - Religious Corporation
 - formed for religious purposes
 - may not distribute corporate assets to members
 - subject to less state regulation
 - Mutual Benefit Corporation
 - formed for any lawful purpose
 - may distribute corporate assets to members on dissolution
- Nonprofit Unincorporated Associations
- Charitable Trusts



Map of Tax Exempt Entities

- Federal and State Tax Law – numbers below refer to Internal Revenue Code sections
 - 501(c)(3) - charitable organizations
 - Public Charity
 - Private Foundation
 - 501(c)(4) - social welfare organizations
 - 501(c)(5) - labor & agricultural organizations
 - 501(c)(6) - business leagues
 - 501(c)(7) - social clubs
- There are other code sections; these are the most common.



Major Differences

Section 501(c)(3)	Section 501(c)(4), (c)(5), (c)(6), (c)(7)
Donors receive a tax deduction for charitable contributions	Donors do not receive a tax deduction for charitable contributions
Lobbying must not be a substantial part of its activities	Unlimited lobbying is allowed as long as it is related to its exempt purpose



Corporate Documents

- **Articles of Incorporation**: corporation's assets must be used for purposes set out in the Articles of Incorporation
- **Bylaws**: operating instructions or constitution



Bylaws

- Members
- Board of Directors
 - 49% rule
 - Call and Notice
 - Quorum
 - Action of the Board
- Committees
- Officers
- Self-Dealing Transactions
- Right of Indemnity
- Annual Financial Reports (120 days after end of the fiscal year)
- Amendments



Board Composition (Section 5227)

- Not more than 49% of the directors may be interested persons
- Interested person:
 - Any person currently being compensated by the corporation for services rendered within the previous 12 months, and
 - Certain members of that person's family



Self-Dealing (Section 5233)

- A transaction to which the corporation is a party and in which one or more of its directors has a material financial interest.
- Unless an exception applies, these transactions are prohibited.



Exception

- All the following facts are established:
 - The corporation entered into the transaction for its own benefit; and
 - The transaction was fair and reasonable to the corporation at the time it entered into the transaction; and
 - Prior to consummating the transaction, all material facts regarding the transaction and the director's interest in it were disclosed to the board; and
 - A majority of disinterested directors then in office determined, after reasonable inquiry, that the corporation could not have obtained a more advantageous arrangement with reasonable effort, and formally approved the transaction.



Attorney General Filings

- Initial Registration
 - Charitable Trust
 - 30 days after organization receives property
- RRF-1 annual filing
 - 4 months and 15 days after end of fiscal year
 - Must also file a copy of the organization's annual IRS return with the Registry of Charitable Trusts at the same time it is due to the IRS



Attorney General Oversight

- Board or board committee must review and approve the compensation of the CEO and CFO
- Audit committee and audited financial statements are required if the organization has \$2,000,000 or more in gross revenue
- Attorney General must be notified of dissolution, merger, or disposition of substantially all of the assets of the corporation



Secretary of State Filings

- Secretary of State [SI-100](#)
 - 90 days after filing articles of incorporation
 - Biennially thereafter by the last day of the month of incorporation
- Filings with Secretary of State when the corporation amends its articles, dissolves, or merges



Recordkeeping

- A nonprofit public benefit corporation must keep:
 - An original or a copy of its articles and bylaws as amended to date at its principal office in California
 - Adequate and correct books and records of account
 - Minutes of the proceedings of its members, board, and board committees
 - A record of its members giving their names and addresses and the class of membership held by each



Tax Exemption

- For federal tax exemption, must file [Form 1023](#) within 27 months of formation for exemption to be retroactive to date of formation
- In California, apply to the Franchise Tax Board using [Form 3500](#)



Obtaining and Maintaining Tax-Exempt Status

- Exempt Purpose
- Unrelated Business Income
- Private Benefit
- Lobbying
- Candidate Activity



Exempt Purpose

- The organization must be organized and operated exclusively for one or more exempt purposes.



Exempt Purpose

- Section 501(c)(3) exempt purposes include charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, or the prevention of cruelty to children or animals.



Examples

- Relief of the poor, the distressed, or the underprivileged,
- Advancement of religion,
- Advancement of education or science,
- Lessening the burdens of government,
- Lessening neighborhood tensions,
- Defense of human and civil rights secured by law,
- Eliminating prejudice and discrimination,
- Erection or maintenance of public buildings, monuments, or works, and
- Combating community deterioration and juvenile delinquency.



Unrelated Business Income

- A Section 501(c)(3) organization must not be operated primarily to conduct an unrelated trade or business.
- Unrelated business income (UBI) is income from:
 - A trade or business that is
 - Regularly carried on and is
 - Not substantially related to the organization's exempt purpose.

There are exceptions, for example, passive income such as interest and dividends.



UBI Tax

- \$1,000 or more gross UBI must file Form 990-T.
- Taxed at corporate rates (except exempt trusts, which are taxed at trust rates).



Private Benefit/Inurement

- A Section 501(c)(3) organization must not be organized or operated for the benefit of private interests such as designated individuals, the creator or the creator's family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.
- No part of the organization's net earnings may inure to the benefit of any private shareholder or individual.



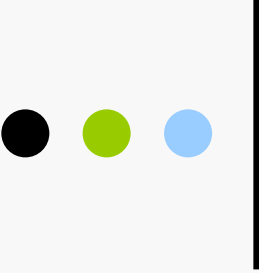
Excess Benefit

- Section 4958 imposes a tax on transactions between a public charity and certain insiders (such as officers and directors and their family members) where the insider receives an excessive economic benefit.
- Often arises in compensation situations.



Presumption of Reasonableness

The charity must take the following steps to create a presumption that no excess benefit transaction occurred and to shift the burden of proof to the IRS.



Presumption of Reasonableness

- The board, composed entirely of individuals who do not have a conflict of interest, must approve the transaction in advance.
- The board must rely upon appropriate comparability data prior to making its determination.
- The board must adequately document the basis for its decision concurrently with making that decision.



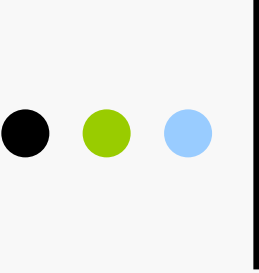
Compare: Private Foundations

- **Self-Dealing**: in general, transactions between a private foundation and insiders are prohibited even if they provide no excess benefit. There are some exceptions.



No Political Campaign Intervention

- Political campaign intervention includes any and all activities that favor or oppose any candidate for public office.
- Examples:
 - Endorsing or opposing candidates for office
 - Soliciting contributions for candidates
 - Providing advertising or publicity for candidates
 - Creating and distributing partisan voter guides
 - Promoting public recognition of candidates



Permissible Election Year Activities

- Voter Education
- Candidate Appearances
- Voter Registration and GOTV
- Issue Advocacy

See Rev. Rul. 2007-41



No Substantial Lobbying

- In general, no organization may qualify for Section 501(c)(3) status if a substantial part of its activities consist of attempting to influence legislation.
- Private foundations cannot lobby.



How much is substantial?

- No clear guidance on how much lobbying is substantial.
 - Less than 5% of an organization's time and effort on legislative activities was considered insubstantial in one case.
 - Courts have since then adopted a vague facts and circumstances analysis considering not only direct expenditures for lobbying but also volunteer and other no cost activities.



501(h) Election -- [Form 5768](#)

- 501(h) Election limits lobbying to a percentage of the organization's exempt purpose expenditures:
 - 20% of the first \$500,000, plus
 - 15% of the next \$500,000, plus
 - 10% of the next \$500,000, plus
 - 5% of the remainder with a cap of \$1,000,000 for all lobbying.
- Of which 25% can be grassroots lobbying



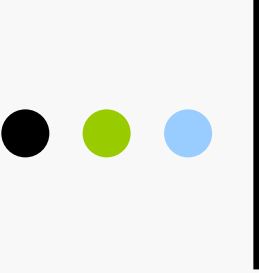
Definitions

- **Exempt Purpose Expenditures**: total of all amounts paid or expenses incurred by the charity to accomplish its charitable purposes.
- **Direct Lobbying**: any attempt to influence legislation through communication with legislators or their staff or any government official or employee who participates in the formulation of legislation.
- **Grass Roots Lobbying**: any attempt to influence legislation through an attempt to affect public opinion.



Public Charity Status

- Statutory Public Charities
 - Churches
 - Schools
 - Hospitals and Medical Research Organizations
- Publicly Supported Organizations



Public Support Test – 509(a)(1)

$$\frac{\text{Public Support}}{\text{Total Support}} = 33 \frac{1}{3}\%$$

If public support is less than 33 1/3% but at least 10%, the organization must satisfy a facts and circumstances test.



Public Support Test

- **Public Support** =
 - gifts, grants, contributions, and membership fees from the government and other publicly supported organizations, and
 - gifts, grants, contributions, and membership fees from all other sources, which are limited to 2% of the total support.
- **Total Support** = all income except capital gains, exempt function income, and unusual grants



Example

\$10,000 Big donor

\$20,000 Bigger donor

\$45,000 Biggest donor

\$20,000 United Way

\$5,000 Dividend & interest

\$5,000 Gross receipts from admissions

Public Support \$26,000 = 26% public support

Total Support \$100,000

Limit on certain contributions: $100,000 \times .02 = \$2,000$



Facts and Circumstances

- Whether the charity is organized and operated in a manner to attract new and additional public or government support;
- Whether the charity's governing body represents the interests of the public;
- Whether the charity's facilities are open to the general public; and
- If it is a membership organization, whether membership is available to and targeted at persons with some broad common interest or purpose.



Advance Ruling Period

- A newly created organization may request a determination that it will be treated as a public charity for its first five tax years.
- If an organization has received an advance ruling, the public support computation is based on all the years in the 5-year advance ruling period.



Annual IRS Returns

- Form 990 or 990-EZ if gross receipts normally exceed \$25,000
- If gross receipts are normally \$25,000 or less, must file 990-N (fiscal years beginning after December 31, 2006)
- Due 4 months and 15 days after end of the organization's fiscal year
- If annual gross income from an unrelated trade or business equals or exceeds \$1,000, must also file Form 990-T



Annual FTB Returns

- Form 199 if gross receipts normally exceed \$25,000
- Due 4 months and 15 days after end of the organization's fiscal year
- If annual gross income from an unrelated trade or business equals or exceeds \$1,000, must also file Form 109